

Message Text

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ACTION EUR-10

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USMISSION OECD PARIS

AMEMBASSY PARIS

AMEMBASSY STOCKHOLM

AMEMBASSY TOKYO

C O N F I D E N T I A L ROME 7788

LIMDIS

PASS TREASURY FOR WIDMAN/TEMPLEMAN

E.O. 11652: GDS

TAGS: EFIN, IT

SUBJECT: ITALY'S ECONOMIC PROBELMS-BALANCE OF PAYMENTS

1. DURING CURRENT DELIBERATIONS PREPARATORY TO C-20 MONETARY MEETING,
IT IS IMPORTANT THAT WE GIVE CAREFUL CONSIDERATION TO THE EXTREMELY
DIFFICULT SITUATION GOI IS EXPERIENCING IN FINANCING ITS BALANCE
OF PAYMENTS DEFICIT. WE ARE CONCERNED THAT, UNLESS ITALIANS RECEIVE
ASSISTANCE BOTH FROM THEIR ALLIES AND THEIR COMMUNITY PARTNERS
IN CONFRONTING THIS PROBLEM, THEY WILL BELIEVE THEMSELVES COM-
PELLED TO TAKE UNILATERAL MEASURES AND EITHER ADOPT ADDITIONAL
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RESTRICTIONS ON CURRENT ACCOUNT TRANSACTIONS OR DEVALUE THE LIRA

BY CEASING SUPPORT OPERATIONS IN EXCHANGE MARKETS. NEEDLESS TO SAY, THIS WOULD HAVE UNWELCOME REPERCUSSIONS ON INTERNATIONAL MONETARY AND TRADE SYSTEM.

2. IF THE SITUATION CONTINUES TO DETERIORATE, THIS COULD RESULT IN A SEVERE POLITICAL SETBACK FOR PRESENT GOVERNMENT AND POSSIBLY THREATEN THE VIABILITY OF ITALY'S TRADITIONAL DEMOCRATIC CENTER-LEFT.

3. THE MAGNITUDE OF ITALY'S ECONOMIC PROBLEM IS READILY EVIDENT. THE TRADE ACCOUNT DEFICIT FOR THE FIRST FOUR MONTHS IS ABOUT \$4.4 BILLION. PRELIMINARY MONETARY MOVEMENTS DATA FROM JANUARY 1 THROUGH MAY 15 SHOW RESERVE LOSSES OF \$5 BILLION (INCLUDING COMPENSATORY EUROMARKET BORROWINGS). DOMESTIC INFLATION IS CONTINUING UNABATED WITH COST-OF-LIVING INDEX AT 16 PERCENT.

4. GOI HAS ATTEMPTED TO PUT ITS HOUSE IN ORDER THROUGH MONETARY POLICY MEASURES AND IMPOSITION OF AN IMPORT DEPOSIT SCHEME. POSSIBLE TAX INCREASES ARE PRESENTLY BEING DISCUSSED AS AN ADDITIONAL MEANS TO CONTAIN INTERNAL DEMAND AND REDUCE INFLATION. ITALY HAS BORROWED EXTENSIVELY ON EUROMARKET AND HAS MADE USE OF ITS CREDIT LINES WITH ITS EC PARTNERS. HOWEVER, THESE ACTIONS HAVE NOT BEEN SUFFICIENT AND ITALY'S POLICY MAKERS ARE CONTINUING TO SEEK OTHER SOURCES OF FINANCING THE BALANCE OF PAYMENTS DEFICIT. IN BOTH INTERNATIONAL AND EUROPEAN MONETARY DISCUSSIONS, ITALIAN REPS ARE ACTIVELY SEEKING A SOLUTION TO THE GOLD QUESTION WHICH WOULD PERMIT UTILIZATION OF GOLD STOCKS AT A MARKET-RELATED PRICE BY CENTRAL BANKS TO SETTLE BALANCE OF PAYMENTS SURPLUSES AND DEFICITS

THEY HAVE ALSO SHOWN A GREAT DEAL OF INTEREST IN INTERNATIONAL DISCUSSIONS CONCERNING RECYCLING OIL FUNDS FROM BALANCE OF PAYMENTS DEFICIT OIL-IMPORTING COUNTRIES

5. GIVEN ITALY'S FINANCING PROBLEM AND THE IMPLICATIONS OF FAILURE TO RESOLVE THIS PROBLEM, IT IS EXTREMELY IMPORTANT THAT THE US MAKE A STRONG EFFORT TO ASSIST ITALY IN A MULTILATERAL CONTEXT. THE POLITICAL LEADERSHIP LOOKS TO US FOR HELP AND IF WE SEEM TO BE UNWILLING OR UNRESPONSIVE THE DC'S CONFIDENCE IN ITS ABILITY TO GOVERN COULD BE ERODED FURTHER.

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6. IT SEEMS REASONABLE THAT, IN EXCHANGE FOR SUCH ASSISTANCE, GOI BE REQUESTED TO UNDERTAKE CERTAIN INTERNAL STABILIZATION MEASURES, SUCH AS EXERCISING GREATER CONTROL OF PUBLIC EXPENDITURES AND INCREASING TAXES. THERE IS SOME EVIDENCE THAT THE DC PARTY IS ALREADY THINKING IN THESE TERMS AND IT MAY MAKE IT EASIER FOR THE GOVERNMENT TO IMPOSE HIGHER TAXES OR TAKE OTHER SIMILAR UNPREDICTABLE STEPS--IN KEEPING WITH THE "CARLI CURE"--WHICH ARE NECESSARY COMPLEMENTS TO EXTERNAL ASSISTANCE. BEAUDRY

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